Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
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Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	
Federal-State Joint Board on	)	
Universal Service Seeks Comment	)	
On Certain of the Commission's	)	
Rules Relating to High-Cost Universal	)	
Service Support and the ETC Designation	)	
Process	)	

COMMENTS
of the
ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

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SUMMARY

The Joint Board must take great care to ensure that the measures it recommends to ensure the sustainability of the High-Cost program would not inadvertently defeat the program's fundamental purpose. Specifically, it must ensure that its recommendations will encourage infrastructure investment in rural areas so that rural consumers continue to have access to high-quality services that are affordable and reasonably comparable to the services and rates offered in urban areas.

There is effective intermodal competition throughout the service areas of rural telephone companies. This competition has led to a decline in wireline network usage as well as flat line growth for rural ILECs. Therefore, it is not necessary, nor in the public interest, to artificially incent competition in rural service areas through the liberal granting of ETC status.

Based on current data, it is quite reasonable to project that the size of the High-Cost program will grow to an unsustainable level in a relatively short amount of time, if the current support portability rules and CETC designation practices for rural service areas remain unchanged. Once one CMRS provider obtains ETC status in a rural area, the other CMRS providers in the area will be compelled to seek ETC designation as well in order to remain competitive. This has already begun to happen. It is estimated that if all wireless carriers nationwide were granted ETC status, the annual funding level of the High-Cost program would grow by more than $2 billion.

The current support portability rules for rural service areas makes it possible for competitors to receive a windfall of support in excess of their own costs, thereby incenting them to seek ETC designations where high-cost support is not needed. In

addition, it is impossible to discern how CETCs use support that is based on the incumbent's actual spending record. Equal support for carriers with significantly different costs, incentives and responsibilities is not competitively neutral, does not properly balance the statutory goals of competition and universal service, and does not promote efficient competition in high-cost areas.

The unjustified support payments and uneconomic competition created by the current portability rules should be addressed by basing support for CETCs in rural service areas on their own embedded costs. This would result in support for CETCs that is "specific" and "sufficient," but not more so, and would better ensure that the support they receive is actually being used for the purposes for which it is intended. This change in methodology should be made as soon as the Commission can develop cost reporting requirements for CETCs.

Consistent with a methodology that calculates CETCs' support based on their own actual costs, CETCs should be required to affirm that they qualify for support based on their own costs associated with the purchase of UNEs. Since these costs are already public, this requirement can become effective immediately.

During the interim period until the change in the support calculation methodology for CETCs is made, USAC should be directed to take measures that will prevent abuse of the rules for determining the location of a line served by a mobile wireless ETC. There is evidence that such abuse is occurring today.

There should not be any type of artificial caps imposed on cost-based high-cost support in rural service areas. When a state commission or the FCC finds that designating an additional ETC in a rural service area is in the public interest, both the

incumbent and the CETC should be able to count on specific, predictable and sufficient support. At the very least, rural ILECs should not have their support reduced in any manner as a result of additional ETC designations.

The Joint Board should promptly abandon other support calculation proposals such as basing support on the lowest-cost provider's costs or utilizing auctions to award high-cost support. These proposals are entirely at odds with the High-Cost program's statutory purposes. They would not provide ETCs with the proper incentives to invest in network infrastructure and would seriously jeopardize the quality, "comparability" and ubiquity of service in high-cost areas.

Similarly, the Joint Board should jettison the idea of limiting support to primary lines and/or primary residences. Before rural ILECs will invest in infrastructure, they must have a reasonable expectation that they will recover the costs of their networks. Limiting support to primary lines would stifle investment, since there would be no certainty as to how much support a carrier would receive and whether that support would be sufficient to recover its network costs. If the designation of multiple ETCs in a rural service area is found to be in the public interest, then regulators should be willing to support the network costs of each of those ETCs.

All of the same administrative complexities that arose under the primary/non-primary line distinction for SLCs would also arise in the context of a primary line high-cost support policy. It is also likely that a new type of "slamming" would arise where some carriers may be driven to switch consumers' choice of primary line provider without their knowledge.

Limiting support to primary lines would make the cost of additional lines that are often used for access to information services unaffordable for some consumers. It would also make the rates for second lines in rural areas incomparable with the rates available in urban areas, which would be detrimental to small businesses and rural economies.

If the Commission ultimately decides to limit support to primary lines, rural ILECs should have complete pricing flexibility for unsupported second lines. Rural ILECs should also immediately be relieved of their carrier of last resort obligations.

The Joint Board should recommend the adoption of the public interest principles and standardized criteria proposed in the OPASTCO white paper, *Universal Service: A Congressional Mandate At Risk*. Public interest principles and standardized criteria are needed to guide state commissions and the FCC in their consideration of ETC applications for rural service areas. This is essential to securing the long-term sustainability of the High-Cost program in a manner that is also consistent with the statutory objectives of the program.

State commissions and the FCC have generally not been following the intent of Congress in their evaluations of the public interest when considering additional ETC applications for rural service areas. Congress recognized in section 214(e)(2) of the Act that supporting competition would not always serve the public interest in the areas served by rural telephone companies. Therefore, the costs and benefits of designating an additional ETC must be carefully weighed by regulators if limited federal funding is to be managed for the optimum public benefit. Regulators must also be certain that the applying carrier is capable of, and committed to, providing true universal service and prepared to meet all of the same standards and obligations as the ILEC.

CETC designations in rural service areas should be made at the study area level. The ability of competitors to creamskim through the adoption of more narrowly defined service areas only serves to increase the ILEC's cost of providing service to the remaining customers.

Finally, when the Commission revises its rules for calculating CETC support, rural ILECs should have another opportunity to self-certify a disaggregation plan. Of course, this will only be necessary if the Commission decides not to adopt a support calculation methodology for CETCs based on their own costs.

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I. INTRODUCTION

The Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) hereby submits these comments in response to the Federal-State Joint Board on Universal Service's (Joint Board) Public Notice, released February 7, 2003.[1] OPASTCO's comments are limited to the rules and policies that apply to the areas served by rural telephone companies. OPASTCO takes no position on the rules that apply to non-rural ILEC service territories.

OPASTCO is a national trade association representing approximately 500 small incumbent local exchange carriers (ILECs) serving rural areas of the United States. Its

[1] *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support and the ETC Designation Process*, CC Docket No. 96-45, Public Notice, FCC 03J-1 (rel. Feb. 7, 2003) (Public Notice).

members, which include both commercial companies and cooperatives, together serve over 2.6 million customers. All of OPASTCO's members are rural telephone companies as defined in 47 U.S.C. §153(37). In addition, they are all eligible telecommunications carriers (ETCs) in their service areas.

OPASTCO members offer an array of services to their rural customers in addition to the voice-grade wireline telecommunications services they provide as ILECs. For instance, 95 percent of OPASTCO members are Internet service providers (ISPs). Approximately two thirds are providing advanced services, such as digital subscriber line (DSL) services. Approximately one half provide some type of commercial mobile radio service (CMRS), and more than half provide some type of video service, such as cable.

OPASTCO commends the Joint Board for its comprehensive Public Notice on the Federal Communications Commission's (FCC, the Commission) rules relating to high-cost support in competitive study areas, the rules regarding support for second lines and the process for designating ETCs. The Notice is timely given that the size of the High-Cost program has been experiencing significant growth in recent years, raising the concern that funding may, at some point, no longer be permitted to grow or could even be curtailed. Clearly, certain rules and processes need to change if the High-Cost program is to remain viable for the long-term.

However, the Joint Board must take great care to ensure that the measures it recommends to the FCC to secure the sustainability of the High-Cost program are consistent with the Telecommunications Act of 1996 (1996 Act, the Act) and would not inadvertently defeat the program's purpose. Specifically, it must be certain that the rules and policies it recommends will promote investment in critical infrastructure in rural

areas so that rural consumers continue to have access to high-quality services that are affordable and reasonably comparable to the services and rates offered in urban areas.

Rural ILECs are the only providers of ubiquitous, high-quality, facilities-based telecommunications service throughout their respective service areas. For these carriers, high-cost universal service support has always been, and continues to be, a critical means of genuine cost recovery that has made the provision of modern, affordable service possible in high-cost areas. Thus, if rural ILECs lose the ability or incentive to continue investing in their networks – or worse yet, if their existence is placed at risk – then some rural areas may be deprived of basic universal service where high-quality, reliable telecommunications services are available and affordable to all. Insufficient high-cost funding also threatens these carriers' ability to offer services to their customers, as well as to schools, libraries and rural health care facilities, that are comparable to those found in urban areas. Such an outcome would be completely at odds with our nation's historic commitment to universal service and with the universal service principles Congress codified in the 1996 Act.[2]

II. STATE OF THE MARKETPLACE AND UNIVERSAL SERVICE FUND: COMPETITION IS THRIVING IN RURAL SERVICE AREAS AND DOES NOT REQUIRE AN ARTIFICIAL "JUMP START" FROM REGULATORS

A. Rural ILECs are facing significant intermodal competition in their service areas

There is robust intermodal competition in the areas served by rural telephone companies. Today, most of this competition is coming from CMRS providers. Virtually every member of OPASTCO has at least one unaffiliated CMRS provider serving in their

[2] 47 U.S.C. §254(b).

territory. The FCC's Seventh CMRS Competition Report states that rural markets, on average, have slightly more than three CMRS providers.[3]

At present, CMRS is subscribed to by most consumers as a complement to their wireline service. That is, most consumers are not canceling their subscription to wireline telephone service when they subscribe to a mobile wireless service.[4] However, CMRS is a substitute for wireline network *usage*. Network usage is critical to rural ILECs' revenue flows since a significant percentage of that usage represents inter- and intrastate toll calls for which rural ILECs provide access services.[5]

Many consumers are using their mobile wireless service as a substitute for their traditional wireline toll service.[6] This is due to the fact that many of the calling plans offered by the nationwide CMRS providers include "free" nationwide long distance. AT&T has attributed the decline in its long distance calling volumes and revenues in part to mobile wireless substitution.[7] In addition, OPASTCO members indicate that some

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[3] *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, Seventh Report, 17 FCC Rcd 12985, 13023 (2002) (Seventh CMRS Competition Report).

[4] Analysts estimate that three to five percent of wireless customers use their wireless phones as their only phone. *See,* Seventh CMRS Competition Report, 17 FCC Rcd 13017.

[5] On average, only 69 percent of rural carriers' intrastate minutes of use is local. This compares with 85 percent local minutes for non-rural carriers. In addition, 21 percent of rural carriers' total minutes are interstate toll minutes compared with 16 percent for non-rural carriers. *See, The Rural Difference*, Rural Task Force White Paper 2 (Jan. 2000), pp. 40-41.

[6] The FCC acknowledged the substitution of mobile wireless services for interstate calls on the wireline network when it raised the wireless safe harbor for CMRS providers to use when reporting interstate telecommunications revenues for universal service contribution purposes. *See, Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms*, CC Docket No. 98-171, *Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990*, CC Docket No. 90-571, *Administration of the North American Numbering Plan and North American Numbering Plan Cost Recovery Contribution Factor and Fund Size*, CC Docket No. 92-237, NSD File No. L-00-72, *Number Resource Optimization*, CC Docket No. 99-200, *Telephone Number Portability*, CC Docket No. 95-116, *Truth-in-Billing and Billing Format*, CC Docket No. 98-170, Report and Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952, 24965, para. 21 (2002).

[7] Seventh CMRS Competition Report, 17 FCC Rcd 13018.

customers are not choosing presubscribed interexchange carriers (PICs) and are using CMRS for all of their long distance calling.

Further evidence of CMRS substitution for wireline network usage comes from the Yankee Group's 2002 Mobile User Survey. The survey found that the increase in wireless call volume has come at the expense of wireline calling, with consumers saying wireless has displaced about 26 percent of their wireline calls. This is up from 16 percent in 2000.[8] And, according to a USA Today/CNN/Gallop poll, almost one in five mobile telephony users regard their wireless phone as their primary phone.[9]

In addition to CMRS, competition from Internet Protocol (IP) networks also effects wireline network usage. For instance, the use of e-mail, instant messaging, the World Wide Web and certain types of IP telephony often substitute for calls that would have otherwise been made on the wireline network.

Data from the National Exchange Carrier Association (NECA) illustrates the impact of competition on minutes of use for rural ILECs. From 1997 through 2000, the average minutes of use per line per month for NECA common line pool[10] members rose each year, from 211.8 in 1997 to 226.7 in 2000. But, in 2001, the average monthly minutes of use per line dropped to 223.0, and in 2002 it fell again to 221.9.[11] Of course, these are just averages. Some rural ILECs, like OPASTCO member Ellensburg Telephone Co. in Washington, have been hit particularly hard by mobile wireless competition. In 2001, Ellensburg's total annual access minutes of use was 120,319,258.

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[8] Keith Mallinson, *2002 Mobile Users Survey Results Part 1: Will Next-Generation Data Services Close the "Value Gap,"* Yankee Group Reports (Sept. 16, 2002).
[9] Seventh CMRS Competition Report, 17 FCC Rcd 13017.
[10] The year-to-year comparisons of common line pool members' minutes of use is based on a consistent 1,167 study areas.
[11] Average minutes of use per line per month for NECA common line pool members: 1997 – 211.8, 1998 – 217.4, 1999 – 224.7, 2000 – 226.7, 2001 – 223.0, 2002 – 221.9.

One year later, in 2002, its minutes of use had dropped to 112,371,844 -- a decline of 6.6 percent.

Along with its impact on network usage, competition has also caused a downward trend in the growth rate of rural ILEC access lines. For the members of the NECA common line pool, lines were growing at an average annual rate of between four and five percent from 1997 through 2000. However, in 2001, line growth fell to approximately two percent, and in 2002, it was essentially flat.[12]

Based on recent studies, it would seem that either flat or negative growth rates for rural ILEC access lines would be the most reasonable forecast for the foreseeable future. For example, a study by International Data Corp. found that by the end of 2001, CMRS had displaced 10 million access lines, primarily by consumers choosing wireless over installing additional access lines.[13] In addition, an increasing number of CMRS providers offer service plans designed to compete directly with wireline local service.[14] And, a January 2002 study by Forrester Research found that the next five years will see 5.5 million more consumers giving up their second lines and 2.3 million more consumers dropping their primary lines to substitute wireless service.[15]

Also impacting line growth in rural service areas is the growing popularity of broadband Internet access services. For example, many rural ILECs provide DSL services, which provide a substitute for the second line a customer may have purchased to use for dial-up Internet access. Similarly, many rural ILECs have cable companies

[12] From 1997 to 1998, average line growth among NECA common line pool members was 4.7 percent. From 1998 to 1999 line growth was 4.7 percent. From 1999 to 2000 line growth was 4 percent. From 2000 to 2001 line growth was 2.2 percent. From 2001 to 2002 line growth was 2/10 of 1 percent.
[13] Seventh CMRS Competition Report, 17 FCC Rcd 13017.
[14] *Id.*, 17 FCC Rcd 13018.

serving in their territories which also may offer cable modem service as a means to access the Internet.

IP telephony will likely provide yet another serious competitive threat to rural ILECs' access revenues in the very near future. Business Week reports that "Internet cable telephony is nearly ready for prime time" and that cable could take 10 percent of the national phone market in six years.[16] Similarly, the previously mentioned Forrester Research study predicted that by 2006, broadband voice over IP services will displace 4.26 million traditional lines.[17]

The Joint Board asks to what extent, if any, is there a relationship between competitive entry and the receipt of high-cost support by competitive eligible telecommunications carriers (CETCs). Initially, there was no such relationship. Mobile wireless providers sought after and obtained spectrum licenses for rural areas, either through auction or lottery, without any expectation of receiving high-cost support. CMRS providers have been successfully serving rural markets for many years now without any high-cost funding. However, over the past couple of years it has become apparent that state commissions and the FCC will designate additional ETCs in rural service areas with minimal restriction. As a result, high-cost support now figures into many CMRS providers' business plans (and the expectations of financial markets), regardless of whether or not the support is truly needed for their provision of service.[18]

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[15] Telecommunications Reports, *"Analysts: Wireless Displacement of Wireline Services Will Rise,"* (May 6, 2002), pp. W-2-3. *See also*, Forrester Research Press Release, *"Consumers Make the Shift to Wireless at Home According to New Research From Forrester,"* (Jan. 29, 2002), p. 1 (Forrester Study Press Release).
[16] Steve Rosenbush, Ron Grover, Charles Haddad, "*Broadband Telephony,*" The Business Week 50 (Spring 2003), p. 170.
[17] Forrester Study Press Release, p. 1.
[18] For example, ALLTEL Corp. has recently applied for ETC status for its wireless operations in Virginia, Alabama and Michigan. It has been reported that ALLTEL made the decision to seek ETC status for its wireless properties "purely for business reasons" and that it "has faced increasing financial pressures to

A study cited in the FCC's Seventh CMRS Competition Report demonstrates that CMRS providers were able to provide service in rural markets, at rates reasonably comparable to those charged in urban markets, before virtually any mobile wireless providers had even received ETC status. The October 2001 study conducted by Econ One[19] compared the CMRS pricing plans in 25 rural markets with the CMRS pricing plans in the top 25 U.S. cities. The study found that "there was virtually no difference in the average monthly charge for wireless service between the two groups." In fact, the charge for rural markets was 2.9 percent less than it was in the top 25 markets. If CMRS providers are able to provide "reasonably comparable" services and rates in rural areas without high-cost support, it becomes questionable whether subsidizing these carriers is the most judicious use of limited federal resources.

In sum, it is clear that there is effective competition throughout the service areas of rural telephone companies. This competition has led to a decline in wireline network usage as well as flat line growth. In turn, this has caused the loss of critical local and access revenues for rural ILECs.

Uneconomically designating one or more CETCs in an already competitive rural market will simply accelerate the ILEC's loss of revenues. This, in turn, will necessitate either an increase in the ILEC's universal service funding or customer rate increases in order for the ILEC to continue providing high-quality service to all of the consumers in its service area. Moreover, the loss of revenues can result in the delay or even cancellation of planned network investments.

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seek such status for its own [wireless] holdings." *See, "ALLTEL Applications for Wireless ETC Status Raises Red Flags Among Rural Wireline Carriers*, TR Daily (April 25, 2003).

[19] Seventh CMRS Competition Report, 17 FCC Rcd 13023.

Therefore, it is not necessary, nor in the public interest, to artificially incent competition in rural service areas through the liberal granting of ETC status. Competition is already there.

B. The size of the High-Cost program will grow to an unsustainable level if the methodology for calculating high-cost support for CETCs and the process for designating CETCs in rural service areas remain unchanged

The Joint Board asks to what extent is support for CETCs likely to grow over time. The most recent data cited in the Public Notice is from the third quarter of 2002, in which 45 CETCs received approximately $14 million. Since that time, support to CETCs has grown considerably. In the first quarter of 2003, 84 CETCs were projected to receive approximately $26.7 million.[20] In the second quarter of 2003, 91 CETCs are projected to receive approximately $36.7 million.[21] It appears that approximately 97 percent of CETC high-cost funding is being received by wireless carriers.[22] In addition, 69 of the 91 existing CETCs -- 76 percent -- have been designated in rural telephone company service areas.[23] When looking at this data in its totality, it is quite reasonable to project that the size of the High-Cost program will grow to an unsustainable level in a relatively short amount of time, if the methodology for calculating CETC support and the process for designating CETCs in rural service areas remain unchanged.

As discussed above, there is robust CMRS competition in rural areas. The Commission's Seventh CMRS Competition Report describes wireless price competition

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[20] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2003* (Nov. 1, 2002), Appendix HC01.
[21] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2003* (Jan. 31, 2003), Appendix HC01.
[22] *Id*. The division between wireline and wireless carriers was determined by the presence or absence of words such as "wireless" or "cellular" in each company's name (with the exception of a few carriers such as Smith Bagley, Inc. where it was certain that the carrier employs wireless technology).

as "intense" and "aggressive."[24] Moreover, "small market carriers…are subject to the same competitive pressures as the large market carriers."[25]

Spectrum auction policy was driven by the dual goals of generating funds for the U.S. Treasury and creating competition in the local market as quickly as possible. It was never fully thought through whether all of this competition would be sustainable for the long term or beneficial for consumers in all circumstances. Now, in many markets, there is a tremendous amount of excess capacity that cannot be supported by actual demand, and CMRS providers are compelled to price below cost in order to maintain market share. As a result, there is anecdotal evidence that this intense price competition has caused some CMRS providers to apply for ETC designation in order to cover up bad business plans and avoid bankruptcy.

Once one CMRS provider obtains ETC status in a rural area, the other CMRS providers in the area will be compelled to seek ETC designation as well in order to remain competitive and stay in business. This is already occurring. For example, throughout Iowa many rural telephone company study areas have two, and in some cases even three mobile wireless providers that have been designated as ETCs.[26]

It is estimated that if all wireless carriers nationwide were granted ETC status, that the annual funding level of the High-Cost program would grow by more than $2 billion.[27] An increase of this magnitude would totally overwhelm the ability of the High-

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[23] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2003* (Jan. 31, 2003), p. 10
[24] Seventh CMRS Competition Report, 17 FCC Rcd 13012.
[25] *Id.*, 17 FCC Rcd 13024.
[26] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2003* (Jan. 31, 2003), Appendix HC07.
[27] This estimate was determined by taking the current 69 percent ratio of wireless to wireline lines and multiplying it by the projected $3.2 billion of portable ILEC high-cost funding for 2003. This estimate is

Cost program to continue supporting the provision of affordable, high-quality service – or in some cases, any service – to customers living in high-cost remote areas of the nation. Clearly, this would be an inefficient use of scarce national resources and is not in the public interest.

III. METHODOLOGY FOR CALCULATING SUPPORT IN COMPETITIVE STUDY AREAS: SUPPORT FOR CETCS IN RURAL SERVICE AREAS SHOULD BE CALCULATED USING THEIR OWN EMBEDDED COSTS

A. The current system of support portability in rural telephone company service areas incents uneconomic competition, unnecessarily swells the size of the USF and is not competitively neutral

Presently, CETCs operating in rural telephone company service areas receive the same per-line support amount as the ILEC would receive for serving a particular customer.[28] The support received by a rural ILEC, in turn, is generally based on its embedded cost of providing the supported services.[29] These portability rules are not competitively neutral, do not properly balance the statutory goals of competition and universal service, and do not promote efficient competition in high-cost areas.

The Joint Board asks to what extent do the costs of CETCs differ from the costs of incumbents. The data necessary to answer this question is not available since CETCs, unlike incumbents, have no obligation to submit cost studies. Thus, CETCs know how much support they will be able to receive based on the ILEC's costs, yet no one knows what the CETC's actual costs are or how the support they receive is being used.

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considered to be conservative, since it assumes that mobile wireless carriers will not increase the number of lines that they report in the service areas with the highest per-line support payments.

[28] 47 C.F.R. §307(a)(1).

[29] 47 C.F.R. §36.154(c), 47 C.F.R. §54.301, 47 C.F.R. §69.612, 47 C.F.R. Part 54, Subpart K. For average schedule companies, universal service formulas for local switching support and high-cost loop support are developed by NECA using data from a sample group of average schedule carriers and from similarly situated companies that file cost data. The formulas are used to determine the support amounts for all average schedule carriers.

There is no basis upon which to presume that CETCs and ILECs have the same costs or that providing identical support will provide each CETC the "sufficient," but not excessive, support called for by section 254(b)(5) of the Act. Section 254(b)(5) also provides that universal service support mechanisms should be "specific," but allowing CETCs to receive per-line support that is identical to the incumbent is not at all specific to the CETC's costs and circumstances.

The Joint Board notes that the FCC previously rejected the argument that its portability rules are not competitively neutral, reasoning that if the CETC can serve the customer's line at a significantly lower cost, this may indicate a less efficient ILEC.[30] However, this ignores the fact that ILECs and CETCs are not at all similarly situated. For instance:

- CETCs are free to decide under what rates and terms they will offer service. Rural ILECs do not have that freedom; their rates and terms are typically regulated by state commissions under tariff.

- CETCs have the freedom to avoid building infrastructure in the highest-cost areas by reselling the rural ILEC's highest-cost loops, which it may acquire at prices reduced by the ILEC's universal service support. Competitive carriers are also not required to demonstrate their ability to provide ubiquitous service at the time of their request for ETC designation.[31] Rural ILECs, as the recognized carriers of last resort in their service areas, have built ubiquitous, high-quality infrastructure that serves the most remote and highest-cost customers.

- CETCs can potentially be designated for a different, and sometimes significantly smaller service territory than the incumbent's study area. This makes it much easier for a competitive carrier to meet the Act's prerequisites for ETC designation. In some cases it also allows the competitor to seek designation only in the segments of the ILEC's study area that have the greatest profit potential and ignore the less lucrative, higher-cost areas.

[30] Public Notice, fn. 44 (citation excluded).
[31] *Federal-State Joint Board on Universal Service, Western Wireless Corporation Petition for Preemption of an Order of the South Dakota Public Utilities Commission*, CC Docket No. 96-45, Declaratory Ruling, 15 FCC Rcd 15168, 15174-15175, para. 17 (2000).

- CETCs are not held to the same service quality and reliability standards and customer billing requirements generally imposed on ILECs by state commissions.

In short, ILECs assume the full obligations of a carrier of last resort, offering reliable, high-quality, facilities-based service to everyone in their service territory. CETCs, on the other hand, receive the ILEC's cost-based support, but with significantly fewer expectations and requirements placed on them.

Awarding CETCs the rural ILEC's per-line support amount enables a competitor to seek and obtain ETC status only where the support will give it a competitive advantage over the ILEC. Thus, when a CETC responds to the arbitrage incentives created by the existing rules, its per-line costs are most likely lower than the incumbent's costs. While it is theoretically possible that a competitive carrier could have higher per-line costs than an incumbent, it is doubtful that such a competitor would choose to enter a market under those conditions.

Moreover, as the Rural Task Force (RTF) and the FCC have previously observed, the ILEC's cost per line increases as it loses lines to a CETC, since it must recover its fixed costs from fewer lines.[32] In contrast, the economies of scale available to the CETC may well lower its cost per subscriber as it captures lines from the ILEC or adds new lines. In other words, as the ILEC's per-customer cost rises, a CETC's per-customer cost is likely to fall. Yet, due to the ILEC's increased cost per customer, the CETC receives more support under the present system as its unit costs are going down. Thus, while it is essential for the ILEC to receive increased per-line support as it loses customers to avoid

[32] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244, 11294-11295, para. 125 (2001) (RTF Order).

stranded investment, that increased per-line support translates into pure windfall in the hands of a CETC.

In addition, certain high-cost support mechanisms may be inapplicable to some CETCs. For example, it would be a highly unusual coincidence for a national mobile wireless provider to need local switching support (LSS). LSS is received by rural ILECs that have less than 50,000 access lines. It recognizes that small carriers have fewer customers over which to spread the costs of switch upgrades and permits those carriers to assign an additional portion of their switching costs to the interstate jurisdiction for recovery. In comparison, a large CMRS provider serving throughout a state may only need one switch to serve all of the customers within the state. Thus, they have the economies of scale that the small ILECs lack. Yet, under the existing rules, a large mobile wireless ETC still receives LSS in each of the small rural ILEC service areas in which it has been designated.[33]

Similarly, long term support (LTS) and interstate common line support (ICLS) are mechanisms designed to stabilize, reduce, and ultimately eliminate the carrier common line access rate that rate-of-return regulated ILECs charge to interexchange carriers (IXCs). LTS was instituted in 1989, concurrent with voluntary common line pooling, to ensure that carrier common line access charges for small rural carriers participating in the NECA pool remained at or near the national average. It was subsequently moved into the universal service fund (USF, the Fund) in 1998. Likewise, ICLS, which became effective on July 1, 2002, was a revenue neutral shift of cost recovery for rural ILECs that

[33] For example, 28 percent of US Cellular's high-cost support in Iowa is attributable to LSS, despite the fact that US Cellular is serving over 200,000 lines in Iowa. *See*, Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2003* (Jan. 31, 2003), Appendices HC01, HC04.

previously occurred through access charges.[34] Neither mechanism provides rural ILECs with any additional revenues than they received prior to their implementation. Yet, mobile wireless ETCs receive LTS and ICLS, even though they do not have common line access charges that require offsetting or elimination. They are not even required to lower their end-user rates or improve their services in order to qualify for the support.

Section 254(e) of the 1996 Act requires that support be used only for the provision, maintenance and upgrading of facilities and services for which the support is intended. Since the support received by rural ILECs is based almost entirely on their own past actual investment and expense payments, or reductions in other rates, it is clear that the support has been used for the purposes for which it is intended. However, it is impossible to discern how competitors will use support based on the *incumbent's* actual spending record. A state's or a CETC's certification[35] that support is being used for appropriate purposes is suspect, at best, when CETCs need not capture customers, add new customers, change their rates, increase investments, improve their services, or make any other legitimate use of the payments that they receive.

Thus, it is unfortunate but not surprising when a Salomon Smith Barney report on Western Wireless states that Western's "USF subsidy represents an incremental revenue source" and that that "the incremental revenue is almost all margin."[36] For rural ILECs, high-cost support is genuine cost recovery for infrastructure that provides high-quality service to all of the customers in the service area. On the other hand, high-cost support that goes straight to the bottom line in order to benefit shareholders is regulatory arbitrage

[34] 47 C.F.R. Part 54, Subpart K.
[35] 47 C.F.R. §54.314(a), (b).
[36] *Western Wireless (WWCA): USF Provides Upside to Our EBITDA*, Salomon Smith Barney (Jan. 9, 2003), p. 2.

that conflicts with the goals of the Act, unnecessarily inflates the size of the USF and needlessly raises the end-user surcharges on consumers' bills.

In sum, providing CETCs with support based on the ILEC's costs results in exactly the sort of excessive ratepayer burden section 254(e)'s limitation on the use of support is intended to avoid. Furthermore, equal support for carriers with significantly different costs, incentives and responsibilities is the opposite of the Commission's principle of competitive neutrality.[37] Therefore, as discussed below, the Commission should address the unjustified support payments and uneconomic competition engendered by the current portability rules by basing support for CETCs in rural service areas on their own embedded costs.

B. Calculating support for CETCs in rural service areas on the basis of their own embedded costs is lawful, beneficial to consumers and competitively neutral

CETCs serving rural telephone company service areas should receive support that is based on their own embedded costs of providing the supported services. Unlike the present system of portability, this methodology would result in "specific" and "sufficient" support for CETCs, consistent with section 254(b)(5) of the Act. It would also promote compliance with section 254(e)'s requirement that support only be used for the provision, maintenance and upgrading of facilities and services for which the support is intended. This would provide greater assurance that consumers actually received some benefit from a competitor's receipt of support. In addition, basing CETCs' support on their own actual costs would promote efficient competitive entry in high-cost areas, since competitive carriers would no longer have perverse incentives to seek ETC status merely to receive

[37] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8801, para. 47 (1997) (Universal Service First Report and Order).

windfall support payments. Also, utilizing the same support calculation methodology for CETCs that is used for rural ILECs is consistent with the Commission's principle of competitive neutrality.

It is not forbidden "regulation" to require a competitive carrier to justify the need for support collected from the nationwide users of the network. Many competitive carriers – particularly CMRS providers – have argued that it is unlawful to ask competing carriers to calculate their costs of service to qualify for support. It is as if applicants for hurricane disaster assistance took the position that they could not be asked to demonstrate that they had been affected by hurricane damage because financial information and information about the condition of their property is private.

Section 332(c)(3) of the Act, which generally preempts states from regulating the rates and entry of CMRS providers, explicitly does not prohibit a state from regulating "the other terms and conditions" of commercial mobile services. In addition, nothing in section 332(c)(3) "exempts providers of commercial mobile services from requirements imposed by a State commission on all providers of telecommunications services necessary to ensure the universal availability of telecommunications service at affordable rates." If a carrier is going to receive limited federal high-cost funding, collected from the nation's ratepayers, then that carrier should be required to demonstrate above-average costs that justify the receipt of support.

There should be cost reporting parity between ILECs and CETCs. Ideally, simplified reporting requirements should be developed for all carriers. But, in any event, CETCs should be required to produce the same level of detail in their reporting of costs that ILECs are required to provide. Such uniformity will promote compliance with

section 254(e) by all ETCs and is competitively neutral. Obviously, the specific types of costs reported by wireless ETCs and ETCs using other technology platforms will need to differ from the types of costs that LECs are required to report. However, that does not mean that the level of detail required from every ETC, regardless of technology, should be any different.

The Commission may also wish to consider developing an average schedule-like option for CETCs that would provide these carriers with a choice between submitting their own annual cost study or relying on formulas that would simulate the embedded costs of similarly situated carriers using the same technology. This would afford CETCs the same options as rural ILECs and give them the same opportunity to avoid the administrative costs of developing an annual cost study.

The change in methodology for calculating CETCs' high-cost support should be made as soon as the Commission can develop cost reporting requirements for these carriers. There should be a high level of confidence that the High-Cost program, which is ultimately funded by the nation's ratepayers, is being used for its intended purposes by all carriers receiving support.

C. Basing support for CETCs in rural service areas on forward-looking economic costs has the same pitfalls for these carriers as it does for rural ILECs

The use of a forward-looking economic cost model to calculate high-cost support for CETCs in rural service areas would be likely to pose the same problems for these carriers as it does for rural ILECs. To begin with, just like a rural ILEC, the costs of a competitor's actual network, constructed over time, are likely to diverge from a model that calculates the hypothetical costs of building a super-efficient network from scratch,

using the most up-to-the-minute technology. Furthermore, even assuming, *arguendo*, that it was appropriate to use forward-looking economic costs to calculate CETC support for rural service areas, there is still the issue of actually developing a model that consistently produces reasonable estimates of those costs. It has yet to be demonstrated that such a model can be produced.

In its thorough analysis of the FCC's Synthesis Model used to calculate non-rural carriers' high-cost support, the RTF found that the costs generated by the model were likely to vary widely from reasonable estimates of forward looking costs.[38] The RTF recognized that unlike the large Bell companies who have the ability to "average out" discrepancies in the model's cost calculations, for rural carriers –

> the result of errors or radical changes in the amount of explicit support developed from a model which is imprecise at the company level could cause an individual carrier to either gain a substantial windfall or have a serious deficiency in "sufficient" support.[39]

In order to provide the proper incentives for carriers to seek ETC designation in high-cost areas and encourage network investment, support levels need to be predictable and sufficient, but not excessive. The RTF's findings demonstrate that the use of a forward-looking cost model for carriers serving predominantly high-cost rural areas does not result in the predictable and sufficient support called for by the Act.

In addition, basing CETCs' support on a different cost methodology than is used to determine rural ILECs' support would not be competitively neutral. Therefore, support for all ETCs in rural service areas, both incumbents and competitors, should be based on their own actual embedded costs.

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[38] *Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 16 FCC Rcd 6165, 6181 (2000) (RTF Recommendation).

At the very least, the Joint Board should make no recommendation that would disrupt the stability for the method of calculating rural ILECs' high-cost support until at least July 1, 2006, as guaranteed by the Commission's RTF Order. In its recommendation to the Joint Board, the RTF urged that its proposals for modifying the embedded cost support methodology for rural carriers remain in place for a five year period so that rural carriers would be provided "with predictable and stable [high-cost] funding to motivate investment over the near-term future."[40] The FCC concurred with the RTF, recognizing that:

> …providing rural telephone companies with a predictable level of universal service support during a five-year period will create a stable environment that will enable rural telephone companies to continue providing supported services at affordable rates to rural America.[41]

On that basis, the Commission determined that the RTF's modified embedded cost mechanism would remain in place for rural carriers for a five-year period, which began on July 1, 2001.[42] Consequently, any modification of the existing methodology for calculating high-cost support for rural ILECs, prior to July 1, 2006, would be premature and jeopardize the predictability and stability that the five-year RTF plan presently offers.

D. Calculating support for CETCs on a per-line basis is inappropriate since high-cost support is intended to recover the costs of networks, not individual lines

Cost calculations for all ETCs, both rural ILECs and CETCs, should be based on network costs, not per-line costs. The calculation of an ILEC's per-line support amount is just a contrivance to determine the amount of support a CETC will receive under the

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[39] *A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies*, Rural Task Force White Paper 4 (Sept. 2000), p. 8.
[40] RTF Recommendation, 16 FCC Rcd 6178.
[41] RTF Order, 16 FCC Rcd 11309, para. 167.
[42] RTF Order, 16 FCC Rcd 11250, para. 12.

current portability rules. A rural ILEC's support has always been based on the actual embedded costs of constructing and maintaining its network. Likewise, a CETC's support should be based on the actual embedded costs of constructing and maintaining its network. This will ensure that every ETC receives sufficient support, but not more so, to encourage and achieve the network infrastructure investment in high-cost areas that is the purpose of the High-Cost program.

E. When a CETC leases UNEs at known and documented prices, support should be based on the CETC's UNE-based costs

Consistent with a methodology that calculates support based on an ETC's own actual costs, CETCs should be required to certify or submit data affirming that they qualify for support based on their own costs associated with the purchase of unbundled network elements (UNEs).[43] Because these costs are already public and known, this requirement can become effective immediately and does not need to wait until the Commission develops cost study requirements for CETCs.

When the state-mandated price a CETC pays for a UNE falls below the cost threshold for high-cost support, providing the CETC with ILEC-based support is a blatant violation of section 254(e), since it is impossible for that support to be used for the purpose for which it was intended. Instead, it gives the CETC a windfall that allows it to either earn additional profit or to lower its rates to levels that would be unsustainable absent this unjustified subsidy. This sort of opening for regulatory arbitrage invites uneconomic competition in high-cost areas and is not competitively neutral. Therefore, the high-cost support received by a CETC using UNEs should immediately become based on the actual price they pay for the UNE.

F. It is unnecessary to impose any type of artificial cap on cost-based high-cost support so long as state commissions and the FCC perform thorough and balanced public interest analyses when considering additional ETC applications for rural service areas

There should not be any artificial caps imposed on rural high-cost support, either on the overall size of the program or on the amount available to an individual ETC. Nor should funding to all ETCs in a rural service area be capped in any manner. Section 254(b)(5) of the 1996 Act states that support should be predictable and sufficient. Caps, whether imposed on the overall Fund, the service area, or individual ETCs, is an arbitrary impediment to the predictability and sufficiency of cost-based support intended to ensure affordable and "reasonably comparable" services and rates for rural consumers.

This is not to say that OPASTCO is not concerned with the rapid growth in the size of the USF in recent years. We are. However, when a state commission or the FCC finds that designating an additional ETC in a rural service area is in the public interest, then both the incumbent and the CETC should be able to count on specific, predictable and sufficient support. If ETCs do not have the support necessary to continue investing in high-cost infrastructure, then the public interest will not be served by those carriers. At the very least, rural ILECs, as the recognized providers of ubiquitous, high-quality, facilities-based service in their areas, should not have their support reduced in any manner as a result of additional ETC designations.

In Section V of these comments, OPASTCO recommends public interest principles and standardized criteria to guide state commissions and the FCC in their consideration of CETC applications for rural service areas. One of the purposes of these principles and criteria is to assist regulators in performing thorough and balanced public

[43] *See*, OPASTCO comments on ACS of Fairbanks, Inc. Petition for Declaratory Ruling and Other Relief,

interest analyses. If this is done properly, then only the most qualified carriers that truly serve the public interest will receive the ETC designation and the benefits derived from each CETC will outweigh the costs of supporting them. In addition, basing CETCs' support on their own actual costs will prevent the receipt of unjustified windfall support payments.

Together, these two recommendations – standardized public interest principles and criteria, and basing CETCs' support on their own costs – should be effective in preventing the High-Cost program funding requirements from spiraling out of control. Nevertheless, if after a period of time, the Commission believes that the High-Cost program has become too large, then the solution is not the imposition of arbitrary caps. Instead, the Commission should scrutinize the CETC designations that have been made in rural service areas and reassess whether or not the benefits of each of those designations outweigh the costs.

If the Commission finds that the costs of certain CETC designations outweigh the benefits, then it should recommend to the relevant state commission that they decertify the carrier or, in cases where the FCC made the designation, simply decertify the carrier itself. If, however, the Commission is confident that the benefits derived from each of the CETC designations that have been made continue to outweigh their costs, then there is no reason why all ETCs should not continue to be fully funded based on each carrier's embedded costs. It makes no sense to certify multiple ETCs in a rural service area on the finding that it serves the public interest, and then curtail funding so that no carrier has support that is sufficient to provide quality, affordable and "reasonably comparable" service to high-cost consumers.

G. Until the FCC is able to implement a support calculation methodology for CETCs based on their own embedded costs, it should direct USAC to take measures that will prevent abuse of the rules for determining the location of a line served by a mobile wireless provider

Both the FCC and the RTF have acknowledged that the use of any location address for purposes of identifying the service location of a mobile wireless customer in a service area could allow arbitrage of the universal service support mechanism.[44] This appears to be occurring today. What follows are three examples of significant discrepancies between the number of lines served by an ILEC in a given high-cost service area and the number of lines the CMRS CETC is reporting. All of the examples cited involve US Cellular in Washington state.[45] The data presented, except where noted, can be found in the Universal Service Administrative Company's (USAC) Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2003, Appendix HC03 – High Cost Support Projected Disaggregated for Washington State.

Example 1: Row 107 of Appendix HC03. The SAC is 522408. The ILEC is Century Tel of WA. The CLLI is ELTPWAXX. Zone B. Portable support per-line is $94.31 (column F). The rural ILEC's annual support is $28,516 (column G) which means that the ILEC's monthly support is $2376.33 ($28,516/12) and the number of ILEC lines is approximately 25 ($2376.33/$94.31). US Cellular, however, is reporting 123 lines (column H) and receiving $11,600 in monthly support (column I). If one is to believe US Cellular, either CenturyTel is serving less than one quarter of the population in this zone or every one of CenturyTel's customers has, on average, approximately five US Cellular phones, each with a different phone number.

Example 2: Row 235 of Appendix HC03. The SAC is 522412. The ILEC is Ellensburg. The CLLI is THRPWAXA. Zone B. Portable support per-line is $142.47 (column F). The rural ILEC's annual support is $120,206 (column G) which means that the ILEC's

[44] RTF Order, 16 FCC Rcd 11315-11316, para. 183. *See also*, RTF Recommendation, 16 FCC Rcd 6201.
[45] The high-cost support for ETCs serving in the exchange-based service areas of rural ILECs in the state of Washington has been disaggregated since January 2000. *See, Petition for Agreement with Designation of Rural Company Eligible Telecommunications Carrier Service Areas and for Approval of the Use of Disaggregation of Study Areas for the Purpose of Distributing Portable Federal Universal Service Support*, CC Docket No. 96-45, Memorandum Opinion and Order, 15 FCC Rcd 9921 (1999) (Washington Rural Service Area Designation Order). It requires both rural ILECs and CETCs to report their number of lines within two density zones in each exchange service area. This reporting makes it possible to analyze potential problems with the use of a billing address for locating a line served by a mobile wireless provider.

monthly support is $10,017.15 ($120,206/12) and the number of ILEC lines is approximately 70 ($10,017.15/$142.47). US Cellular, however, is reporting 354 lines (column H) and receiving $50,434 in monthly support (column I). If one is to believe US Cellular, either Ellensburg is serving less than one fifth of the population in this zone or every one of Ellensburg's customers has, on average, approximately five US Cellular phones, each with a different phone number.

Example 3: Row 269 of Appendix HC03. The SAC is 522430. The ILEC is McDaniel. The CLLI is SLKMWAXB. Zone B. Portable support per-line is $18.87 (column F). The rural ILEC's annual support is $87,714 (column G) which means that the ILEC's monthly support is $7,309.50 ($87,714/12) and the number of ILEC lines is approximately 387 ($7,309.50/$18.87). US Cellular, however, is reporting 961 lines (column H) and receiving $18,132 in monthly support (column I). If one is to believe US Cellular, either McDaniel is serving less than one half of the population in this zone or every one of McDaniel's customers has, on average, approximately 2.5 US Cellular phones, each with a different phone number.

There are a couple of other interesting facets to Example 3. First, in Zone A of this CLLI (Row 268), where the portable support per-line ($7.74) is much lower than in Zone B and presumably there is a much larger population (McDaniel has approximately 710 lines in Zone A), US Cellular only reports 33 lines. Second, if one looks at Appendix HC03 of USAC's *First Quarter* 2003 Fund Size Projections Report, US Cellular at that time reported 734 lines for Zone B of this CLLI. Thus, if one is to believe US Cellular, they gained 227 lines in Zone B over a period of three months, a zone in which the ILEC has only 387 lines.

There are many more discrepancies similar to the examples above that can be found throughout the HC03 Appendix. In addition, a review of the HC03 appendices for several consecutive quarters reveals significant churn in the number of lines reported by US Cellular in individual zones, despite the fact that the total support amount and number of lines reported by US Cellular has remained relatively stable. Therefore, until such time as the FCC is able to implement a support calculation methodology for CETCs based on their own embedded costs, the FCC should direct USAC to analyze and investigate these inconsistencies.

The Commission's rules grant authority to the High Cost and Low Income Committee of the USAC Board of Directors to make decisions concerning the

performance of audits of beneficiaries under the high-cost support mechanisms.[46] The rules also give the USF administrator the authority to audit contributors and carriers reporting data to the administrator.[47] USAC needs to undertake that responsibility in cases where there is cause for suspicion that the rules are being abused. In situations where abuse of the system is found to be occurring, at the very least USAC should recover the unwarranted support payments from the carrier. If an ETC's abuse of the rules is extensive, the relevant state commission or FCC should decertify the carrier.

The FCC should also direct USAC to provide quarterly CETC line count data *by ILEC serving area*,[48] to permit public review of CETC line counts similar to what is provided in Appendix HC03. Currently, only the data for US Cellular's operation in the state of Washington is available at this level of detail. Yet, U.S. Cellular has recently been granted ETC status in Wisconsin, where it is reporting approximately five times as many lines as it reports for Washington.[49] In addition, in Iowa, US Cellular receives more high-cost support than any other rural carrier in the state.[50] At a minimum, the public should have the ability to review and question whether the reporting discrepancies found in Washington are unique, or whether similar anomalies exist in other states served by US Cellular, or by any other CETC.

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[46] 47 C.F.R. §54.705(c)(1)(iv).
[47] 47 C.F.R. §54.707.
[48] Appendix HC01 of USAC's quarterly Fund size projections report shows the amount of monthly high-cost support a CETC is projected to receive for an entire state. Appendix HC04 shows the number of working loops a CETC is reporting in an entire state. Appendix HC07 shows the CETCs that have been designated within rural ILEC study areas. However, the critical piece of information that is missing is how many lines a CETC is reporting within a particular rural service area.
[49] *Federal Universal Service Support Mechanisms Fund Size Projections for the Second Quarter 2003*, Universal Service Administrative Company (Jan. 31, 2003), Appendix HC04.
[50] *Id.*, Appendix HC01.

H. Basing support on the lowest-cost provider's costs would jeopardize rural consumers' ability to receive reasonably comparable services and rates and is not competitively neutral

The Joint Board asks for comment on methods for determining support in competitive study areas other than basing it on each ETC's own costs. It first asks whether support in competitive areas should be based on the lowest-cost provider's costs. The problem with this method of determining support is that it does not take into account that ILECs and CETCs are not at all similarly situated.

A CETC may have lower costs than the rural ILEC for several reasons. None of those reasons, however, have anything to do with the CETC being more efficient than the ILEC. To begin with, CETCs are not subject to the same service quality and reliability standards that rural ILECs are often required to meet by state commissions. For example, many state commissions require ILECs to meet stringent standards for:

- sufficient capacity to handle peak network traffic,
- voice quality specifications,
- the time lag in which a customer receives dial tone,
- the completion of called numbers,
- operator and directory assistance answering time,
- and provisions for emergency operation.

In addition, mobile wireless CETCs are often designated for their licensed service area which does not include all of an individual rural ILEC's study area and in many instances includes portions of multiple ILEC study areas. Thus, a cost comparison between the ILEC and the CETC is not valid due to differing economies of scale. Similarly, some states, such as Washington, have divided rural ILECs' study areas into

numerous smaller geographic service areas. This gives competitive carriers the opportunity to seek designation only in those areas where the profit potential is the greatest or the cost to serve is the lowest, while leaving the rural ILEC to serve the less lucrative, higher-cost areas. Finally, CETCs have the option of serving only the low-cost portions of a rural study area with their own facilities and utilizing resale of the incumbent's services to offer service to the high-cost customers.

If rural ILECs received support based on a differently-situated CETC's lower costs, in many cases the ILEC would no longer have the incentive or ability to continue investing in the network infrastructure that provides all of the consumers in the service area with high-quality, reliable service, as well as access to advanced services. In addition, to the extent that an ILEC is not able to recover a certain portion of its costs through high-cost support, it may place upward pressure on local service rates. Thus, the ILEC's support would no longer be sufficient to achieve its intended purpose and rural consumers may no longer be able to rely on services and rates that are reasonably comparable to those available in urban areas. Most negatively affected would be the highest-cost customers who rely on the ILEC as a lifeline and where the CETC's service may be poor or nonexistent. Therefore, the Joint Board should abandon the idea of basing support on the lowest-cost provider's costs, as it would be detrimental to rural consumers and is not competitively neutral.

I. Utilizing auctions to award high-cost support would not provide carriers with the proper incentives to invest in high-cost areas and would seriously endanger the quality and ubiquity of service

The Joint Board should abandon the notion of using auctions to award support for numerous reasons. The high-quality telecommunications services that are available in

high-cost areas are, in large part, a result of a system of support that has provided rural ILECs committed to serving those areas with the ability to continually invest in their networks. Auctioning high-cost support to the lowest bidder places the quality and ubiquity of service in high-cost areas at great risk, since the winning bidder could be the carrier which intends to commit the least amount of resources to the area.

Auctions do not naturally encourage network upgrades and service quality improvements. Even if quality of service obligations were adopted, the winner may only be motivated to do the bare minimum required. It is not sound public policy to auction high-cost support for such a vital part of the nation's critical infrastructure to the lowest bidder. Auctions are a "race to the bottom" and at odds with the Act's emphasis on quality services.[51]

Auctions incorrectly assume that every ETC's services in a given service area are fully substitutable for one another. As discussed in Section II, *supra*, most consumers who subscribe to CMRS view it as complementary to their local exchange service. If a mobile wireless ETC were to win an auction for high-cost support, the rural ILEC may no longer be able to provide affordable service to the highest-cost portions of its territory. In some cases, it may no longer be able to remain a viable entity. As a result, consumers in these areas would be deprived of services that they desire and are not provided by the winning bidder.

There is nothing to prevent large, well financed carriers from "low-balling" their bids in order to ensure that they win the auction. The PCS auctions demonstrated the difficulties of avoiding the deep-pocketed influence of large companies, even in the "entrepreneurs" blocks. A large winning bidder would be incented to focus most of its

resources on the high-margin, densely populated areas that it serves and commit the bare minimum of resources required to the high-cost areas for which the support is intended.

At the same time, there is no incentive for a CETC to provide its lowest bid. ILECs' costs are public knowledge. Presently, CETCs' costs are not. Therefore, some CETCs may not provide their lowest bid, but bid just low enough to undercut the ILEC and win.

Yet another issue is what happens if the auction winner is not able to provide affordable and reasonably comparable services and rates with the level of high-cost support that they committed to in their bid. During the 1970s and 1980s large companies bid for municipal cable television franchises by promising to provide more services at lower cost than their competitors. In many cases the result was as soon as the franchise was acquired, the cable company "discovered" it could not feasibly deliver what it promised and either sold out or negotiated its obligations down. Were an auction-winning ETC unable to provide adequate service with the agreed upon level of support, either the support amount would have to be renegotiated or rates would have to increase, particularly if there was no other carrier still serving the high-cost customers. Such an outcome would be at odds with section 254(b)(5)'s principle of specific, predictable and sufficient support.

More recently, the C Block personal communications service (PCS) auctions have demonstrated that the auction process does not guarantee a winner that will remain solvent or that will be able to provide service to consumers. The same result could occur with universal service auctions, with the added feature that the ILEC who took the initiative to invest in their community may also be irreparably harmed in the process.

[51] 47 U.S.C. §254(b)(1).

These risks are not worth taking in establishing a critical infrastructure provider and carrier of last resort for a rural service area.

Finally, the Joint Board asks how auctions would be implemented in light of section 214(e)(2), which requires states to determine through the ETC process whether the designation of a CETC in a given service area would serve the public interest. An auction changes the circumstances in which the state chooses, in the public interest and in accordance with section 214(e), an additional ETC. After a "race to the bottom" bid, it may no longer be in the public interest for the state to have designated the additional eligible carrier.

Auctions create all of the wrong incentives and pose too many risks to be used as a method for ensuring the continued provision of ubiquitous, high-quality, affordable service in rural America. The folly of auctions should therefore be abandoned.

IV. SCOPE OF SUPPORT: THE HIGH-COST PROGRAM SHOULD SUPPORT THE COST OF NETWORKS, NOT LINES

A. Limiting support to primary lines is inconsistent with the purpose of the High-Cost program as it would inhibit investment in rural network infrastructure

Rural ILECs do not build lines. They build networks. A policy of limiting support to primary lines does not comport with the realities of network design and cost. Networks are not built to fit the exact size of the current subscriber base. Building a network for a rural area involves a relatively long planning horizon and the creation of extra capacity to accommodate future growth in demand. Due to the high cost of deploying rural infrastructure, it is not efficient to upgrade facilities on a frequent basis. Incurring costs once and providing sufficient capacity for the future are necessary planning objectives to minimize long-run cost.

Major components of the costs of a rural ILEC's network are fixed and, within a reasonable range of output, do not go up or down significantly as individual lines are added or disconnected by consumers. The loops contained in a rural ILEC's network are a sunk cost. They are already in place and represent real cost, regardless of whether or not they are being utilized at a particular point in time.

In 1996, the Joint Board had proposed to limit support to a single connection to a subscriber's primary residence and to businesses with only a single connection. This proposal was based on the belief that providing support for second connections and second residences would allow consumers that presumably can afford to pay rates that reflect the carrier's costs to provide services nevertheless would receive supported rates.[52] This rationale demonstrates a complete misunderstanding of the purpose of the High-Cost program.

Section 254(e) of the Act requires that high-cost universal service support be used "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended." Additionally, Section 254(b)(3) states, in part, that consumers in high-cost areas should have access to telecommunications services that are reasonably comparable to those in urban areas and at reasonably comparable rates. Taken together, these two provisions indicate that high-cost support should be utilized for infrastructure investment in areas where it would not otherwise be economically feasible to provide services at rates that are affordable and reasonably comparable to urban areas of the country. High-cost support should never be confused with a program to simply reduce the rates for telecommunications service charged to an individual end-user.[53]

[52] Universal Service First Report and Order, 12 FCC Rcd 8829, para. 95.
[53] This is the purpose of the Low Income program.

Before rural ILECs will invest in infrastructure, they must have a reasonable expectation that they will recover their costs. Section 254(b)(5) of the Act states that support should be predictable and sufficient. Supporting only primary lines would stifle investment, since there would be no certainty as to how much support a carrier would receive and whether that support would be sufficient to recover its costs.[54] Without investment in the network, rural consumers would no longer have access to services that are reasonably comparable to those available in urban areas. It is therefore essential that high-cost support for rural ILECs, as well as for CETCs in rural service areas, be based on the embedded costs of the ETC's network within the designated service area.

B. If the designation of multiple ETCs in a rural service area is found to be in the public interest, then the High-Cost program should support the embedded network costs of each of those ETCs

The main purpose of the proposal to limit support to a primary line and/or to a primary residence is to keep the High-Cost program from becoming "overly expansive."[55] The possibility of an overly expansive and ultimately unsustainable USF under the existing rules is a legitimate concern. However, the size of the Fund must be contained in such a way that does not defeat the primary objective of the High-Cost program; *i.e.*, infrastructure investment in high-cost areas that enables rural consumers to receive high-quality services that are affordable and reasonably comparable to the

[54] The uncertainty rural ILECs would face regarding the sufficiency of support is exacerbated by the Commission's interstate access charge reform for rate-of-return ILECs, in which a significant portion of these carriers' common line costs was shifted from access charges to explicit universal service support. *See, Multi-Association Group (MAG) Plan Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Second Report and Order and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fifteenth Report and Order, *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-97, Report and Order, *Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Report and Order, 16 FCC Rcd 19613, 19642-19646, paras. 61-68 (2001) (MAG Plan Second Report and Order).

[55] Universal Service First Report and Order, 12 FCC Rcd 8829, para. 95.

services and rates offered in urban areas. This objective would not be achieved if support were limited to a primary connection and/or a primary residence.

In Section III of these comments, OPASTCO recommended that the support for CETCs in rural service areas be based on their actual embedded costs. Adoption of this methodology should help to contain the growth in the Fund, since it will eliminate the arbitrage of ILEC-based high-cost support that can occur under the current rules. Furthermore, in section V, *infra*, OPASTCO recommends public interest principles and standardized criteria to guide state commissions and the FCC in their consideration of ETC applications for rural service areas. This recommendation, too, should help to control the growth of the Fund as state commissions and the FCC begin to conduct more thorough and balanced public interest analyses before designating additional ETCs in rural service areas.

One of the public interest principles proposed in Section V is that the public interest is served only when the benefits from supporting multiple carriers exceed the costs of supporting multiple networks. If the costs of funding multiple networks in a rural service area outweigh the benefits, then state commissions and the FCC should not designate additional carriers, keeping in mind that the purpose of the High-Cost program is not to support uneconomic competition. If, however, it is found that supporting multiple carriers in a rural service area is in the public interest, then every ETC's network costs should be supported,[56] so that the High-Cost Program achieves its primary objective of providing rural consumers with affordable and "reasonably comparable" services and rates. It makes no sense to designate multiple ETCs in a rural service area, and then have

[56] This, of course, assumes that the ETC is eligible for support under the rules for the various high-cost support mechanisms.

a "primary line" policy that curtails support to such an extent that no ETC has the predictable and sufficient funding necessary to encourage network investment. This would simply be a poor allocation of limited resources and should therefore be avoided.

C. The administrative complexities that resulted from applying different primary and non-primary residential SLCs would be even greater in the context of a primary line support policy

The Joint Board correctly notes that the Commission has previously acknowledged the administrative difficulties that arose when different subscriber line charge (SLC) rates were applied to primary and non-primary residential lines. Specifically, in the CALLS Access Charge Reform Order, the Commission stated that getting rid of the primary/non-primary line distinction "will go a long way to eliminate the customer confusion that now exists" and "eliminate the costs associated with administering this distinction, which are ultimately borne by customers."[57] The Commission also declined to adopt a primary/non-primary line distinction in the MAG Plan Second Report and Order, taking into consideration that the administrative burdens would be even greater for small rate-of-return carriers than for price cap carriers.[58]

All of the same administrative and enforcement difficulties that arose under the primary/non-primary line distinction for price cap carrier residential SLCs would also arise in the context of a primary line or primary residence high-cost support policy. For instance, the Joint Board asks how primary lines should be defined. If it is a household, how would residences with unrelated individuals be treated (for example, college roommates or families who take in boarders)? If it is an individual, what would stop a

[57] *Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 96-262 and 94-1, Sixth Report and Order*, Low-Volume Long Distance Users,* CC Docket No. 99-249, Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Eleventh Report and Order, 15 FCC Rcd 12962, 13002, para. 100 (2000) (CALLS Access Charge Reform Order).

family from placing each of the lines it subscribes to under a different family member's name, so that they are all classified as "primary"? If only primary residences are supported, there is the administrative complexity of carriers having to share information given the likelihood that a subscriber's primary and second residences are in different service areas.

With regard to the primary/non-primary line distinction for SLCs, surely some savvy consumers "gamed" the system in order to avoid the dollar or two difference between the two rates. Imagine the abuse of the rules that would occur when consumers living in high-cost areas saw the rate difference between a supported primary line and an unsupported non-primary line. Even if this abuse could somehow be minimized through carrier enforcement, it is not the role of carriers to pry into the private living arrangements of their customers. For small rural ILECs, not only would this be costly and administratively onerous, it would also destroy the goodwill they have established with their customers.

Moreover, the Joint Board is correct in suggesting that the problems of limiting support to primary lines may be magnified in a multi-carrier environment. In particular, it is likely that a new type of "slamming" would arise. Under a system where only the primary line receives critical high-cost support, some carriers may be driven to switch consumers' choice of primary line provider without their knowledge.

Clearly, the exceedingly complex mechanisms that would be needed to implement and enforce a rule that limited support to primary lines would fail any reasonable cost/benefit analysis. The Joint Board should not recommend a policy which has already

[58] MAG Plan Second Report and Order, 16 FCC Rcd 19636, para. 47.

been experimented with and ultimately abandoned for its administrative complexity and costliness.

D. A policy of limiting support to primary lines and/or primary residences is contrary to the Act's principles of affordable and reasonably comparable rates

As the Joint Board well knows, second lines are often used for access to the Internet, fax machines and other information services. Many rural subscribers – residences and businesses alike – need access to these information services and devices without forgoing regular voice telephone calls. Limiting support to primary lines would make the cost of additional lines for these services unaffordable for many consumers living in high-cost areas, inconsistent with section 254(b)(1) of the Act. It would also make the rates for second lines in rural areas incomparable to the rates available in urban areas, contrary to section 254(b)(3). Moreover, policies that discourage connections for basic, dial-up Internet service and other information services would hinder the deployment and penetration of advanced services, contravening sections 254(b)(2) and 706.

In addition, the support of second lines is essential to small businesses located in rural communities and for attracting new businesses to these areas. Small businesses create jobs which are vital to the continued viability of fragile rural economies. The smallest rural businesses represent the most vulnerable segment of the business community and they typically have the least ability to pass on increased costs to their customers in the form of higher prices. A small business, with a single telephone line and an additional computer or fax line, has the choice of either dropping one of its essential lines or moving out of the rural area if it wants voice-grade service at a rate that is

reasonably comparable to rates charged in urban areas. Forcing businesses to relocate where rates are reasonable and affordable is antithetical to universal service principles.

The proposal to support only primary residences is also bad public policy. It is a cliché that every second residence is a luxury investment of yuppies and movie stars. Some second residences are owned or rented by working class people whose occupation requires them to make seasonal moves or live apart from their families. Were only primary residences to be supported, some people may be unable to afford access to basic telecommunications services. In addition, nowhere does the Act exclude second residences from section 254's goal of urban and rural rate comparability. In short, supporting only primary lines and/or primary residences would be entirely inconsistent with Congressional intent in the Act's universal service principles and should therefore be abandoned.

E. If support is limited to primary lines, then rural ILECs should have complete pricing flexibility for second lines and be freed from their carrier of last resort obligations

The rate regulation and carrier of last resort obligations imposed on rural ILECs are based on the assumptions that the ILEC is the sole provider in its service area and that the ILEC will be able to recover its costs of providing ubiquitous service throughout its territory. In addition, rural ILECs' local rate tariffs are established with the expectation that federal high-cost support will recover the costs not recovered through customer charges. Clearly, these assumptions and expectations are no longer reasonable under a policy in which support is limited to primary lines and a carrier other than the ILEC can be chosen as the primary line provider.

Therefore, if support is limited to primary lines, rural ILECs should no longer have any obligation to serve a customer for which it has not been chosen as the primary line provider. If a rural ILEC chooses to provide customers with unsupported second lines, it should have complete pricing flexibility for those lines and be able to charge a market-based rate. Furthermore, if only primary lines are supported, there is no guarantee that a rural ILEC will be able to recover its network costs and remain a viable entity. Consequently, rural ILECs should immediately be relieved of their carrier of last resort obligations and have the freedom to exit the market in a timely manner.

V. PROCESS FOR DESIGNATING ETCS: PUBLIC INTEREST PRINCIPLES AND STANDARDIZED CRITERIA ARE NEEDED TO GUIDE STATE COMMISSIONS AND THE FCC IN THEIR CONSIDERATION OF ETC APPLICATONS FOR RURAL SERVICE AREAS

In the Public Notice, the Joint Board seeks comment on several proposals that appear to be intended to contain the growth in the size of the High-Cost program.[59] While these proposals may accomplish their intended objective, they would do so at the expense of defeating the statutory purpose of the program itself: encouraging infrastructure investment in high-cost areas that results in the provision of affordable, high-quality services that are reasonably comparable to the services and rates available in urban areas. OPASTCO believes that a critical step toward securing the long-term sustainability of the High-Cost program in a manner that is also in harmony with the universal service provisions of the Act is to improve the process for designating ETCs in rural service areas.

[59] For example, basing support on the lowest-cost provider's costs, using auctions to award support, capping the support available to all ETCs in a geographic area, and limiting support to primary lines.

To that end, OPASTCO has prepared a white paper entitled *Universal Service In Rural America: A Congressional Mandate At Risk.*[60] Among other things, the paper recommends public interest principles and standardized criteria to guide state commissions and the FCC in their consideration of ETC applications for rural service areas. The details of OPASTCO's views on most of the issues raised in Section II.D. of the Public Notice can be found in the white paper. OPASTCO urges the Joint Board to recommend the proposals contained in the white paper in their entirety.

A. State commissions and the FCC have not been following the intent of Congress in their designation of CETCs in rural service areas

Section 214(e)(2) of the Act provides for ETC designations to be treated differently in the areas served by rural telephone companies as opposed to non-rural ILECs. In the areas served by a non-rural ILEC, section 214(e)(2) requires state commissions and the FCC to designate additional ETCs, so long as the applying carrier is able to meet the requirements of section 214(e)(1). However, in the areas served by a rural telephone company, section 214(e)(2) provides state commissions and the FCC with the discretion to determine whether or not providing more than one carrier with universal service support would be in the best interest of those communities. Specifically, before a competitive carrier can be designated as an ETC in these areas, the state commission or FCC must determine that it is *in the public interest*.

Unfortunately, the majority of the determinations that have been made by state commissions and the FCC thus far have placed an over-emphasis on the perceived benefits of competition and have equated the introduction of financially supported

[60] *Universal Service in Rural America: A Congressional Mandate At Risk* was filed as a written *ex parte* in CC Docket No. 96-45 on January 28, 2003. It is also being filed along with these comments in this proceeding.

competition to serving the public interest.[61] This approach to public interest determinations is problematic as Congress did not presume that supported competition would always serve the public interest in areas served by rural telephone companies. If it had, there would have been no need for section 214(e)(2) to say that state commissions "may" designate more than one carrier, as opposed to "shall" for all other service areas, or require a special public interest determination just for these service areas. This demonstrates Congress's recognition that there could be significant costs and subsequent detriment to rural consumers from financially supporting competition in rural service areas. Thus, factors *other than* the promotion of competition should be playing the dominant role in state commission and FCC public interest determinations.

Both the costs and the benefits of designating an additional ETC must be carefully weighed by state commissions and the FCC if limited federal funding is to be managed for the optimum public benefit. The costs of supporting multiple networks include both the increased funding requirements for any additional ETC, as well as the decreased network efficiency of all carriers that results when multiple carriers serve sparsely populated areas. FCC Commissioner and Joint Board member Jonathan Adelstein made a similar point in a recent speech:

> We must ensure that the benefits that come from increasing the number of carriers we fund outweigh the burden of increasing contributions for consumers. The public interest also demands that regulators seriously consider whether the market can support more than one carrier with universal service. If not, then new designations shouldn't be given as a matter of course just because it appears they meet other qualifications.[62]

[61] For excerpts of state commission and FCC ETC designation orders which demonstrate this over-emphasis on competition, *see, Universal Service in Rural America: A Congressional Mandate at Risk*, pp. 24-27.

[62] *Rural America and the Promise of Tomorrow*, Remarks of Commissioner Jonathan S. Adelstein, NTCA Annual Meeting and Expo, Phoenix, AZ (Feb. 3, 2003).

It is tempting for state commissions, in particular, to designate CETCs in rural service areas in order to bring additional federal dollars into their state. An individual state incurs only a small fraction of the cost of funding the federal USF. Yet, when a state designates a CETC, they receive 100 percent of the benefit of the federal funding that results from that designation. Thus, it is easy to see how, from a state commission's perspective, the benefits derived from designating a CETC will almost always outweigh the costs and will almost always be in the public interest.

It is interesting to note that Utah, which is one of the few examples of a state commission denying a carrier ETC status, did so because it would have also permitted the carrier to draw support from its state universal service fund.[63] Having learned what drives state commissions' ETC decisions, at least one carrier applying for ETC status has explicitly requested only federal high-cost support, and not state support, in the belief that the state commission will be more likely to designate the carrier.[64] State commissions should strive to avoid approaching ETC designations from a parochial viewpoint in order to ensure that limited federal resources are allocated in a manner that maximizes their utility and are properly applied to serve the public interest.

[63] The Utah Supreme Court upheld the Utah commission's decision to deny Western Wireless Corp. ETC status on the rationale that the designation would have increased burdens on the state universal service fund without any offsetting benefits. *See, WWC Holding Co. Inc. v. Public Service Commission of Utah, et al*, Case No. 20000835, 2002 UT 23 (fil. March 5, 2002).

[64] The Regulatory Commission of Alaska, *Request by ALASKA DIGITEL, LLC for Designation as a Carrier Eligible To Receive Federal Universal Service Support Under the Telecommunications Act of 1996*, Case No. U-02-039, Alaska Digitel, LLC's Response to Order Requiring Filings and Addressing Eligible Telecommunications Carrier Criteria (fil. March 10, 2003), p. 34. "Widely considered an anomaly, because all other states that have considered the matter have granted ETC status, the Utah case is inapplicable here because ADT is not requesting state funding."

B. Public interest principles should be established to guide state commissions and the FCC in their consideration of ETC applications for rural service areas

The current practice of liberally designating additional ETCs in the service areas of rural telephone companies is not sustainable, based on the current rate of growth of CETC support payments and the overall size of the USF. Just as important, however, is that in many cases, multiple ETC designations in a rural service area will not serve the public interest. This includes the interests of rural consumers – for whom access to critical telecommunications infrastructure and high-quality, ubiquitous service may be jeopardized – and consumers nationwide who are the ultimate contributors to the USF.

Therefore, the Joint Board should recommend the establishment of the following public interest principles to guide state commissions and the FCC in their consideration of ETC applications for rural telephone company service areas:[65]

1. Rural consumers should receive access to affordable, high-quality telecommunications and information services, including advanced services, that are reasonably comparable to those services provided in urban areas and at reasonably comparable rates.

2. The high-cost support mechanisms should not be used to incent uneconomic competition in the areas served by rural telephone companies.

3. The USF is a scarce national resource that must be carefully managed to serve the public interest.

4. Rural universal service support reflects the difference between the cost of serving high-cost rural areas and the rate levels mandated by policymakers.

5. The public interest is served only when the benefits from supporting multiple carriers exceed the costs of supporting multiple networks.

6. In areas where the costs of supporting multiple networks exceed the public benefits of supporting multiple carriers, the public interest dictates providing support to a single carrier that provides critical telecommunications infrastructure.

[65] Further explanation of these principles can be found in *Universal Service in Rural America: A Congressional Mandate at Risk*, pp. 27-31.

7. The cost of market failure in high-cost rural America could be severe.

C. A standardized set of minimum qualifications, requirements and policies should be established for state commissions and the FCC to apply to potential and existing ETCs in rural service areas

A standardized set of minimum qualifications, requirements and policies is needed for state commissions and the FCC to use in their evaluation of potential and existing ETCs in rural service areas. If a carrier is going to be eligible to receive universal service funding, then every state commission, as well as the FCC, has a duty to ensure that the carrier can, and will, provide true universal service. To date, this has not been happening.

The Joint Board asks to what extent are similar universal service obligations or quality of service obligations not imposed on ILECs and CETCs. As discussed in Section III.A. of these comments, CETCs do not have any obligation to demonstrate that the universal service funding they receive is being used for its intended purposes, such as to build out their networks or improve their services.[66] CETCs are not held to the same service quality standards[67] and customer billing requirements typically imposed on rural ILECs by state commissions. In addition, some state commissions have sought to redefine the service areas of rural telephone companies to well below the study area level.[68] This makes it much easier for a competitor to qualify for ETC designation and encourages creamskimming of the areas with the best customers.

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[66] Since the support received by rural ILECs is based almost entirely on their own past actual investment or expense payments, or reductions in other rates, it is clear that they are using it for its intended purposes.

[67] Some examples of the service quality and reliability standards often imposed on rural ILECs include: sufficient capacity to handle network traffic, voice quality specifications, the time lag in which a customer receives dial tone, the completion of called numbers, operator and directory assistance answering time, and provisions for emergency operation.

[68] *See*, *for example,* Washington Rural Service Area Designation Order, 15 FCC Rcd 9921. *See also*, *Pleading Cycle Established for Comments on Proceeding Regarding the Definition of the Rural Service*

Section 214(e)(4) of the Act requires state commissions to allow any carrier – including the ILEC – to relinquish its ETC designation in any area served by more than one ETC. Within one year after the state commission approves the relinquishment of ETC status, the remaining ETCs must be capable of serving all of the customers served by the relinquishing carrier. Thus, it is clear from this provision, that Congress intended for all carriers that were designated as ETCs to be true providers of universal service and capable of becoming a legitimate carrier of last resort. However, based on the drastically differing standards and requirements imposed on ILECs versus CETCs, as well as the perfunctory nature in which CETCs have been designated, it is obvious that most state commissions and the FCC are not taking to heart Congress's vision of what it means to be an ETC.

The establishment of standardized minimum qualifications, requirements and policies would assist state commissions and the FCC in determining whether or not the public interest would be served by a particular carrier's designation as an ETC. It would also improve the long-term sustainability of the USF as only the most qualified carriers that are capable of, and committed to, being legitimate providers of universal service would be able to receive and retain the ETC designation. There needs to be a high degree of confidence that these obligations can and will be met prior to the granting of ETC status.

The Fifth Circuit Court's decision in *Texas Office of Public Utility Counsel v. FCC* would not prohibit the FCC's establishment of minimum federal guidelines to be applied by state commissions and the FCC to all potential and existing ETCs in rural

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Areas of Two Rural Telephone Companies in the State of Colorado, CC Docket No. 96-45, Public Notice, 18 FCC Rcd 53 (2003).

service areas. That decision overturned an FCC rule which prevented state commissions from imposing additional criteria on potential ETCs.[69] The recommendation being made here would do nothing of the sort. It would simply establish a baseline of qualifications, requirements and policies to be applied to all potential and existing ETCs in rural service areas. Nothing would prevent a state commission from adding their own criteria.

Guidelines should not differ depending upon whether or not the rural exemption has been lifted in the area for which ETC status is sought. A state commission's decision to lift a rural telephone company's exemption from the market-opening obligations of section 251(c) of the Act does not somehow make it appropriate to use a more relaxed set of criteria for ETC qualification. It does not serve the public interest for carriers that are anything less than fully qualified and committed to being true providers of universal service to receive limited high-cost funding, regardless of whether or not the rural exemption is in place.

Therefore, the Joint Board should recommend that in order to be considered for ETC status in a rural telephone company service area, a carrier should be required to demonstrate to the state commission or FCC that it meets, and will abide by, all of the following qualifications and requirements:[70]

1. A carrier must demonstrate its ability and willingness to provide all of the services supported by the federal High-Cost program throughout the service area.

2. A carrier's local usage offering should be evaluated as part of the public interest determination.

3. In fulfilling the requirement to advertise its services and rates, an ETC must emphasize its universal service obligation to offer service to all consumers in the service area.

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[69] *Texas Office of Public Utility Counsel v. FCC*, 183 F.3d 393, 418 (5th Cir. 1999).
[70] For further explanation of these qualifications and requirements, *see*, *Universal Service in Rural America: A Congressional Mandate at Risk*, pp. 31-35.

4. An ETC must actively advertise to Lifeline-qualifying (low-income) consumers.

5. A carrier must have formal arrangements in place to serve customers where facilities have yet to be built out.

6. A carrier must have a plan for building out its network once it receives ETC designation and must make demonstrative progress toward achieving its build-out plan in order to retain ETC designation.

7. A carrier should be evaluated on the ability of its network to remain functional in times of emergency and the extent of its dependence on other carriers' networks to remain functional.

8. A carrier must demonstrate that it is financially stable.

In addition, the Joint Board should recommend that state commissions and the FCC adopt the following policies regarding ETC designations in rural telephone company service areas:[71]

1. ETC designations in rural telephone company service areas should be made at the study area level.

2. State commissions and the FCC should ensure that CETCs will be capable of providing high-quality service to all of the customers in the service area should the rural ILEC find it necessary to relinquish its own ETC designation.

3. Any service quality standards, reporting requirements and customer billing requirements established by the state commission should be applied equally to all ETCs in the state.

4. State commissions have the authority to decertify any ETC that is not meeting any of the qualifications or requirements enumerated above.

The Joint Board should also recommend that state commissions be required to certify annually to the FCC that they are applying the established standardized list of minimum qualifications, requirements and policies to potential and existing ETCs in rural telephone company service areas. Under FCC rules, states are required to file annual certifications with the Commission stating that all federal high-cost support

[71] For further explanation of these policies, *see*, *Id.*, pp. 35-39.

provided to carriers within the state will be used only for the provision, maintenance and upgrading of facilities and services for which the support is intended.[72] This rule recognizes the need for accountability and good stewardship by state commissions in their administration of limited federal high-cost funding.

For the same reason, states should be required to certify annually to the FCC that they are applying the established standardized list of minimum qualifications, requirements and policies to potential and existing ETCs in rural service areas. This would ensure that ETC applications for rural service areas were being evaluated in a relatively consistent manner using the same set of criteria. More importantly, it would help to ensure that the carriers designated as ETCs in rural service areas will truly serve the public interest. Because ETC designation allows for the receipt of scarce federal universal service resources, it is critical that state commissions be held accountable for their designation decisions in rural service areas.

D. CETC designations in rural service areas should be made at the study area level

The Joint Board asks whether state commissions and the FCC should place any weight on the presence of disaggregation zones when determining whether the designation of a CETC below the study area level is in the public interest. It should first be noted that if the Commission adopts a support calculation methodology for CETCs based on their own embedded costs, as recommended in Section III of these comments, then there will no longer be a need for ILECs to disaggregate their support. Nevertheless, regardless of how support is ultimately calculated for CETCs, ETC designations in rural telephone company service areas should always be made at the study area level.

[72] 47 C.F.R. §§54.313(a), 54.314(a).

It is critical for state commissions and the FCC to recognize that the primary purpose of the High-Cost program is not to promote competition. It is to ensure that all consumers – particularly those living in the most remote and highest-cost areas – have access to high-quality telecommunications services that are affordable and reasonably comparable to the services and rates offered in urban areas. The ability of competitors to creamskim through the adoption of more narrowly defined service areas does nothing to promote true universal service. Rather, it only increases the cost of providing service to the remaining customers that only the incumbent has the obligation to serve. This, in turn, places at risk the incumbent's ability and incentive to continue investing in infrastructure that brings high-quality services to these customers.

In addition, when a rural ILEC loses a customer, it loses the revenue earned from access charges and vertical services. These revenues are critical to funding the network upgrades that extend new and advanced services to a greater number of consumers. Thus, designation of CETCs for service areas that are smaller than the ILEC's study area obstructs the availability of advanced services in high-cost rural areas, contrary to the universal service objectives of the Act.

Furthermore, CETCs that are designated for smaller service areas are able to target their marketing to a smaller group of customers than the ILEC, giving them an unfair advantage to attract the best customers. This is inconsistent with the Commission's principle of competitive neutrality.

Some state commissions and the FCC have begun to take the mistaken position that now that rural telephone companies have been permitted to disaggregate their support to below the study area level, this justifies designating CETCs for smaller service

areas. However, disaggregation addresses only one component of the arbitrage opportunities an essentially unregulated competitor has in comparison to a rate-regulated incumbent. With access charges and local rates generally averaged throughout their study areas, incumbents continue to be disadvantaged targets for competitors whose rates can reflect cost differences with greater granularity.

Clearly, the implications of redefining a rural ILEC's service area are great and therefore, CETCs should only be designated for a rural telephone company's entire study area. Nevertheless, if a state commission decides to designate a CETC for a service area other than the rural telephone company's study area, the Act requires that it seek the concurrence of the FCC. Under FCC rules, if the Commission does not act on a state's petition to redefine a rural telephone company service area within 90 days of issuing a Public Notice, it is deemed approved.[73] This rule should be modified to require the FCC to fully review the petition and issue an order before it can take effect. The decision to designate a CETC for a service area other than a rural telephone company's study area is far too consequential to be permitted to take effect by the default of the Commission's non-action.

E. Rural ILECs should have another opportunity to self-certify a disaggregation plan if the FCC modifies the support calculation methodology for CETCs to something other than basing it on their own costs

As a result of the Commission's irrational portability rules, particularly as they pertain to mobile wireless ETCs, many of the highest-cost rural ILECs who would have benefited the most from disaggregating their support were compelled to elect the Path

[73] 47 C.F.R. §54.207(c).

One option of not disaggregating.[74] For example, due to the entirely different network architectures of ILECs and CMRS providers, a customer that is extremely high-cost for an ILEC because it is a great distance from the central office, could be a low-cost customer for a CMRS provider, if that customer is near a highway where a cell tower has been erected. In that situation, if the ILEC had disaggregated its support based on its own relative costs, it would have presented an even greater windfall and arbitrage opportunity for a CMRS provider than under the Path One option where per-line support remains averaged over the entire study area.

Therefore, if the Commission revises its rules for calculating CETC support, rural ILECs should have another opportunity to elect the Path Three option of self-certifying a disaggregation plan,[75] so long as a CETC has yet to be designated in the rural ILEC's study area. Providing rural ILECs with another opportunity to disaggregate and target their support is entirely reasonable in light of any modification to the "rules of the game" under which these carriers first chose a disaggregation path. Of course, providing rural ILECs with this opportunity will only be necessary if the Commission adopts a support calculation methodology for CETCs other than basing it on their own costs.

VI. CONCLUSION

For the reasons set forth in the foregoing comments, the Joint Board should recommend the following to the FCC:

- High-cost support for CETCs in rural service areas should be calculated based on their own actual embedded costs. This change in methodology should be made as soon as the FCC can develop cost reporting requirements for these carriers.
- High-cost support for all ETCs in rural service areas should support network costs, not "primary lines."

[74] 47 C.F.R. §54.315(b).
[75] 47 C.F.R. §54.315(d).

- The public interest principles and standardized criteria proposed in the OPASTCO white paper, *Universal Service: A Congressional Mandate At Risk*, should be adopted to guide state commissions and the FCC in their consideration of ETC applications for rural service areas.

- Until the FCC is able to implement a support calculation methodology for CETCs based on their own costs, USAC should be directed to take measures that will prevent the abuse of the rules for determining the location of a line served by a mobile wireless ETC.

- When a CETC leases UNEs at known and documented prices, high-cost support should be based on the CETC's UNE-based costs.

- There should not be any artificial caps on cost-based high-cost support in rural service areas.

- CETC designations in rural service areas should be made at the study area level.

- Rural ILECs should have another opportunity to self-certify a disaggregation plan if the Commission decides to modify the support calculation methodology for CETCs to something other than basing it on their own costs.

By adopting these recommendations, the Joint Board will ensure the sustainability of the High-Cost program in a manner that continues to achieve the program's purpose and that is consistent with the intent of Congress in the 1996 Act.

Respectfully submitted,

THE ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

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May 5, 2003

CERTIFICATE OF SERVICE

I, Jeffrey W. Smith, hereby certify that a copy of the comments by the Organization for the Promotion and Advancement of Small Telecommunications Companies was sent by first class United States mail, postage prepaid, on this, the 5th day of May, 2003, to those listed on the attached list.

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